Show Me the Money

International Methods of Payment

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Ultimately, any sale is a gift until payment is received. Understanding how to get paid for export transactions is especially crucial, since your buyer could be 10,000 miles away. There are four basic ways to get paid internationally. From the most to the least secure for the exporter, these payment methods are:

CASH IN ADVANCE

New exporters who may be unfamiliar with international payment options most frequently request this method. Their attitude is usually, "I don't know you very well, but if you send me the money, I'll send you the goods." From a buyer's point of view, however, when the money is sent, it is gone and there is no guarantee that the goods will ever be shipped. At that point, the importer has no leverage with the seller, relying totally on the good faith of the exporter. If the importer does not know the exporter well, there will be no basis for such trust. Whether the goods are shipped on time, and to specifications, will depend totally on the integrity of the exporter, so this method is a big risk to the importer.

As you can imagine, by quoting such payment terms, the exporter limits his international sales potential, since competitors might be offering significantly better terms. Are there any risks from an exporter's point of view? One is that "cash in advance" *should only mean* 1) that the exporter will pull stock out of inventory and ship it when money is received, *or* 2) the exporter will *begin* producing the order, if it is not inventory, when money is received. Exporters have been "burned" when they have agreed to these payment terms without having inventory in stock. They would use their own working capital to build an order (perhaps over several weeks or months), only to have the order cancelled. The result is excess inventory, no money, and creditors knocking on the door.

A very popular subset of this method of payment, especially for small commercial orders (generally under $20,000) or direct consumer sales, is the use of credit cards. An advantage is that you can still price your products, and get paid, in dollars; the credit card company will bill your buyer in his local currency, converting the amount into dollars to pay you. Of course, you must be alert to the potential fraudulent use of credit cards. According to a recent survey, 42 percent of all fraudulent orders were international. Obviously, orders originating in some countries present greater risk than others. Several companies sell fraud-screening software, which you may want to investigate on-line.

LETTER OF CREDIT (L/C)

Letters of credit have been instrumental in facilitating international trade for decades, because they replace the creditworthiness of the exporter and importer with that of their respective banks. The parties might not know one another, but they know and trust their own banks. The exporter knows that, when his bank confirms a letter of credit opened abroad, his bank will pay him if the specified documents are in order. The importer opening the letter of credit has confidence that his bank will only make payment when the required documents are presented. One of the required documents usually is a transportation document saying that the purchased goods have been put on board a truck, ship, or plane. Letters of credit are thus paid only when the specified documents have been examined and are found in order. That is why they are called *documentary* letters of credit.

Other normally required documents are a packing list, a bill of lading, an insurance certificate, and a commercial invoice, although other documents such as a certificate of origin or an inspection certificate may be required. One advantage of a letter of credit is that it cannot be amended or cancelled unless all parties agree. In addition, having a U.S. bank add its confirmation, meaning that the U.S. bank agrees to pay if the documents are in order, can reduce the risk under a letter of credit. Always make sure that your buyer sends your L/C through the international banking system. Banks have a process called "advising" letters of credit. This checks the authenticity of letters of credit. Occasionally, a letter of credit will look letter-perfect but in

fact will be fraudulent. Never ship a product until your banker has authenticated your L/C.

The upside to this payment method is that the buyer is more comfortable that the specified goods will be shipped as required, and the seller is more confident that payment will be received as agreed. The downside is that this method will tie up either the buyer's cash or credit line and that competing firms might offer more favorable payment terms.

DOCUMENTARY COLLECTIONS

In this case, the exporter sends the required documents (including the bill of lading, which serves as a title document) through his bank to the importer's bank. The importer must come into the bank and either pay cash (cash against documents) or agree to pay (documents against acceptance) before the bank will release the documents so that the importer can pick up the goods at customs. Under documentary collections, the exporter maintains control of the title document by using the banking system. So, if the importer changes his mind and never shows up at the bank, the exporter can sell the goods to a third party in the importer's country or bring the goods back to the United States.

OPEN ACCOUNT

International open account terms are similar to domestic open account terms. The product is shipped and the buyer agrees to pay in a set number of days (for instance, 30, 60, or 90) from the invoice or shipment date. In this case, the buyer has the goods and the exporter has a promise. If a large multinational company makes the promise, it is probably good. However, if the exporter does not know the importer well—and wants to sleep at night—he can buy credit insurance on the overseas accounts receivable. These policies normally will insure the accounts receivable 90 to 95 percent against commercial risk (that the buyer won't pay) and 95 to 100 percent against political risk (that nonpayment will be the result of some foreign government action).

Insurance is available either through private sector insurance companies or the U.S. Export-Import Bank. To insure your accounts receivable worldwide could cost less than three-quarters of 1 percent of the invoiced amount, depending on the quality of buyers and country risk involved. By insuring overseas accounts receivable, an exporter might be able accept orders that normally would have been turned down because of the overseas risk—which would be passed on to the insurer. Such insurance would also allow the exporter to borrow against the insured accounts receivable since, from a lender's point of view, the risk has moved from a foreign country to a major insurance company or the U.S. government.

As an exporter you always quote price, delivery or ship date, and a method of payment. While letters of credit are used extensively in Asia, Africa, the Middle East, and Latin America, especially when the relationship is new or the commercial, economic, or political risks might be relatively high, they are used less frequently in Europe. In Europe, documentary collections is a more acceptable method to use in the early stages of a relationship, and a request for a letter of credit from a reputable buyer might be taken as an insult. Open account terms can be used for well-established customers in low risk countries, or in situations where there is a great deal of competition but credit insurance is available.

It is very important to know your customer, and what terms are commonly used in a target country, before you begin negotiating the method of payment. Being aware of these options, and when to use them, could make a big difference in your international sales success.